Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)	CC Docket No. 00-256
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Access Charge Reform of Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	)	CC Docket No. 98-77
	)	
Prescribing the Authorized Rate of Return For Interstate Services of Local Exchange Carriers	)	CC Docket No. 98-166

COMMENTS OF THE LEC MULTI-ASSOCIATION GROUP

FILING ASSOCIATIONS:

National Rural Telecom Association

National Telephone Cooperative Association

Organization for the Promotion and Advancement of Small Telecommunications Companies

United States Telecom Association

William F. Maher, Jr.
Stephen L. Goodman
Halprin, Temple, Goodman & Maher
555 12th Street, N.W.
Suite 950 North
Washington, DC 20004
202/371-9100
Its Counsel

February 26, 2000

TABLE OF CONTENTS

Page

SUMMARY

The LEC Multi-Association Group (NRTA, NTCA, OPASTCO, and USTA) urges the Commission to adopt the MAG Plan in its entirety. The Plan best meets the Commission's multiple policy goals for rural and insular areas under the Communications Act. The Plan resolves the numerous interstate regulatory issues that face the non-price cap LECs. These carriers include most of the small and mid-sized LECs that serve the rural and insular areas of the United States.

The Plan proposes reforms similar to those in the pending recommendation of the Rural Task Force ("RTF"), although there are differences between the Plan and the RTF recommendation. The Group supports the Commission's efforts to consider promptly both the RTF recommendation and the Plan. The Plan also is similar, but not identical, to the regulations for price cap LECs and interexchange carriers ("IXCs") that the Commission adopted based on a proposal of the Coalition for Affordable Local and Long Distance Service ("CALLS").

The Plan addresses in a unified way the interstate policy issues associated with non-price cap LECs. The Plan reforms the interstate access charge structure and universal service system applicable to non-price cap LECs while implementing optional forms of incentive regulation (Path A) and rate-of-return regulation (Path B) that are consistent with the NECA pooling system. This two-path approach is necessary to accommodate the diversity that the Commission and the RTF have recognized among non-price cap carriers. The Plan's similarities with the structure of the *CALLS Order*, Path B's retention of existing forms of rate-of-return regulation, and the continuation of NECA's centralized tariff and pooling system will help minimize the practical effects of any purported regulatory complexity.

The Plan's proposed reform of the interstate access charge system is the best possible for the efficient provision of services to the public. The SLCs of all non-price cap LECs will increase, tracking the SLC caps for carriers subject to the *CALLS Order*. For Path A LECs, the plan also establishes a weighted per-minute aggregate target for these rates, known as the Composite Access Rate ("CAR"). The Plan lowers the CAR to 1.6 cents per minute on average by two years after the start of the transition period for Path A LEC study areas that participate in the pool. At the 1.6 cents per minute level, the CAR reflects a percentage reduction in the per-minute switched access rates of non-price cap LECs comparable to that of the *CALLS Order*. These access charge changes will achieve substantial consumer benefits by promoting more efficient cost recovery. The adoption of similar SLCs for price cap LECs and non-price cap LECs is consistent with the rural-urban rate comparability provisions of section 254(g) of the Act.

The Plan substantially advances the universal service principles of the Act for customers in the service areas of non-price cap LECs. For both Path A and Path B LECs, the Plan immediately removes the "interim" cap on high cost loop support and the corporate operations expense limitation. Although the interim cap had only a minor effect on investment when first imposed, it now has a major annual impact. With the caps now in place, customers lose. The current caps artificially limit the universal service support available to all carriers. Even the areas that are most in need of upgrades must make do with less in any given year that the cap operates.

The Plan defines Rate Averaging Support (the "RAS") as a new, portable explicit support mechanism available only to the study areas of Path A LECs that participate in the NECA pooling system. The Commission has lawful discretion to implement the RAS as defined in the

Plan. The immediate availability of the RAS in Path A will ensure sufficient support while motivating non-price cap LECs to move to Path A and incentive regulation. Path A incentive regulation in turn will send the proper economic signals to promote efficient competition. The Plan's reform of the access charge system for both Path A and Path B LECs, consistent with the *CALLS Order*, goes far to removing implicit subsidies from that system while maintaining sufficient support.

The Plan's proposed form of incentive regulation under Path A also advances the public interest by freezing Path A LECs' revenue per line ("RPL") in real terms. In doing so, the Plan ensures that Path A LECs subject to such regulation have strong incentives to improve their efficiency. In the pooling environment of non-price cap LECs, RPL-based regulation provides enhanced incentives for cost reduction and investment in new technologies by breaking the link between Path A LECs' costs and their revenues. Path A incentive regulation should encourage long term investment in new technologies, including investment in high-speed infrastructure.

Indeed, the Plan provides strong incentives for Path B LECs and Path A LECs to deploy technologies that can support advanced services, consistent with section 706 of the Act. As a policy matter, the Plan is not designed to require the use of universal service funding to support advanced services.

The Commission should immediately reform its rules regarding mergers and acquisitions involving non-price cap LECs. These rules effectively discourage LECs in rural and insular areas from acquiring and upgrading telephone exchanges. The harms they seek to protect against are highly speculative. In particular, the Commission should repeal the "all-or-nothing" rule, the freeze on study area boundaries for non-price cap carriers, and section 54.305 of the Rules.

Section 54.305 discourages non-price cap LECs from acquiring and upgrading inferior telephone exchange plant, contrary to the Act's universal service goals.

The Plan's proposed regulations would strictly enforce the geographic averaging requirement of section 254(g) of the Act. With the more economically efficient access charges that will result from the Plan, IXCs will more readily be able to satisfy the section 254(g) requirement. Although IXCs are nondominant carriers for which the Commission does not actively regulate rates, the Commission has ample authority under the Act to enforce IXCs' obligations pursuant to section 254(g) and the regulations for implementing it proposed in the Plan.

The Plan satisfies the goals of the Regulatory Flexibility Act as well as the Communications Act. The Plan will benefit small business entities, including small incumbent LECs, IXCs, and new entrants, and permit them to control their administrative and regulatory burdens.

Because the Plan serves the public interest, the Commission should adopt it in its entirety, at the earliest possible time.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)	CC Docket No. 00-256
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Access Charge Reform of Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	)	CC Docket No. 98-77
	)	
Prescribing the Authorized Rate of Return For Interstate Services of Local Exchange Carriers	)	CC Docket No. 98-166

COMMENTS OF THE LEC MULTI-ASSOCIATION GROUP

I. INTRODUCTION

The LEC Multi-Association Group (the "Group")[1] respectfully submits comments on the above-captioned notice of proposed rulemaking (the "Notice") regarding the comprehensive plan (the "Plan") that the Group filed on October 20, 2000 in a petition for rulemaking (the

1 The Group consists of the National Rural Telecom Association ("NRTA"), the National Telephone Cooperative Association ("NTCA"), the Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO"), and the United States Telecom Association ("USTA"). The National Exchange Carrier Association ("NECA") provided numerical support regarding the Plan and, as seen in Attachment 1, views regarding scheduling its implementation.

"Petition").[2] The Group urges the Commission to adopt the Plan in its entirety as presented in the Petition.

The Plan best meets the Commission's multiple policy goals for rural and insular areas under the Communications Act of 1934, as amended by the Telecommunications Act of 1996 (collectively the "Act"). The Plan does so by resolving the numerous regulatory issues that face the incumbent local exchange carriers ("LECs") not subject to price cap regulation (hereinafter "non-price cap LECs"). There are more than 1000 of these carriers, many of which belong to one or more of the associations in the Group. Non-price cap LECs include most of the small and mid-sized LECs that serve the rural and insular areas of the United States. As noted in the Petition, the Plan is the product of significant compromises among the associations in the Group and their member LECs.[3]

The Plan proposes universal service reforms similar to those in the pending recommendation of the Rural Task Force ("RTF"),[4] although there are differences between the Plan and the RTF recommendation. The Group endorses many of the RTF's policy positions, but in some cases moves further in the same policy direction. In contrast to the RTF

---

2 *See Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers,* Notice of Proposed Rule, 66 Fed. Reg. 7725 (Jan. 25, 2001). Among the attachments to the Notice as released by the Commission are a Detailed Description of the Plan ("Plan Description") and Proposed Amendments To the Code of Federal Regulation ("Proposed Amendments"), both of which were exhibits to the Group's Petition.

3 The Group believes that this rulemaking proceeding is an excellent forum for addressing any concerns that may be raised by other parties. However, as discussed in section II below, the Commission should adopt the Plan in its entirety.

4 *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service (rel. Sept. 29, 2000) ("RTF recommendation").

recommendation, the Plan provides a comprehensive approach to access reform and incentive regulation as well as universal service.

The differences between the Plan and the RTF recommendation are the result of the Group's consideration of the additional issues facing non-price cap LECs that were not the focus of the RTF recommendation. The Group supports the Commission's efforts to consider promptly both the RTF Recommendation and the Plan. The Group believes that this proceeding, rather than the RTF proceeding, is best suited to addressing all of these issues, especially access and incentive regulation, in a coordinated and unified way. In considering the Plan as well as the RTF recommendation in these separate proceedings, the Commission should seek an integrated resolution of the multiple issues that face non-price cap LECs and their customers.

The Plan also is similar, but not identical, to the regulations for price cap LECs and interexchange carriers ("IXCs") that the Commission adopted in May 2000 based on a proposal of the Coalition for Affordable Local and Long Distance Service ("CALLS").[5] When adopted, the Plan will have benefits for consumers and regulation for non-price cap LECs that are consistent with those of the *CALLS Order*. The Plan differs from the *CALLS Order* because it addresses the high costs, the diverse service and cost conditions, the existing NECA pooling system, and the complex regulatory structure that apply to most non-price cap LECs in serving

5 *See Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262 *et al.*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, FCC 00-193, 15 FCC Rcd 12962 (2000) (the "*CALLS Order*").

their customers.[6] Indeed, the Commission has recognized this diversity and complexity by deferring reform of access charges and universal service for these carriers until now.

In these comments, the Group answers the numerous questions posed in the Notice. These comments demonstrate that adoption of the Plan will serve the public interest and should occur as quickly as possible. An affidavit of Dr. James H. Vander Weide, Research Professor of Finance and Economics, Fuqua School of Business, Duke University (the "Vander Weide testimony") and quantitative estimates support the Group's position.[7] The Vander Weide testimony discusses the economic and consumer welfare characteristics of the Plan.

II. THE COMMISSION SHOULD ADOPT THE PLAN AS A WHOLE TO REALIZE ITS PUBLIC INTEREST BENEFITS

The Commission should adopt the Plan in its entirety as proposed in the Petition. The Plan addresses in a unified, balanced, and cohesive way the interstate policy issues associated with non-price cap LECs. These issues include reform of the access charge system, universal service, rate of return regulation, and separations. The Commission currently has separate dockets pending for all of these matters.[8] Resolution of these interrelated issues will provide major benefits to consumers and service providers.

---

6 The RTF has documented the diversity of rural and insular service areas and their differences from urban areas. *See* RTF, *The Rural Difference*, White Paper 2 (Jan. 2000).

7 The Vander Weide testimony is Attachment 2 to these comments. The Group originally submitted the Vander Weide testimony as Exhibit 2 to the Petition.

8 *See, e.g., Prescribing the Authorized Unitary Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Notice Initiating a Prescription Proceeding and Notice of Proposed Rulemaking, 13 FCC Rcd 20561 (1998) ("Represcription Notice"); *Access Charge Reform For Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation,* CC Docket No. 98-77, Notice of Proposed Rulemaking, 13 FCC Rcd 14238 (1998)

With multiple Commission proceedings pending, non-price cap LECs are subject to substantial regulatory uncertainty at the federal level. Regulatory uncertainty lowers non-price cap LECs' incentives to invest, and it increases their cost of capital.[9] As telecommunications competition increases in the service areas of non-price cap LECs, regulatory uncertainty complicates the response of those LECs to competitive pressures. As the RTF recommendation notes, such uncertainty also hinders the efforts of competitive LECs ("CLECs") as they remain unsure of the ground rules for competition. Regulatory uncertainty is especially harmful because competition in the service areas of non-price cap LECs focuses on lower cost, high volume business customers. Many non-price cap LECs serve only a few such customers, which may represent a substantial portion of their revenues.

In addition to the need for certainty, the diverse nature of non-price cap LECs makes it imperative that a flexible regulatory framework successfully addresses the conditions that such LECs face. The Plan's features, and particularly the two regulatory paths – "Path A" and "Path B" – that it proposes, are designed to accommodate the great diversity of non-price cap LECs. These LECs range in size from those serving a few hundred customers to those serving many thousands. They serve the most rural areas of the United States as well as some more densely populated areas. The Plan accounts for these differences, and does so in a comprehensive, flexible manner.

("Access Notice"); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8889, 8936 (1997) (holding that existing high-cost support mechanisms for rural LECs shall remain in place until at least January 1, 2001); *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Recommended Decision, FCC 00J-2 (Jt. Bd. rel. July 21, 2000).

9 *See* Joint Direct Case and Comments of Local Exchange Carrier Associations, CC Docket No. 98-166 (filed Jan. 19, 1999) at 7-11.

The Plan therefore provides a unified way to achieve both certainty and flexibility while resolving the Commission's pending proceedings. By implementing a detailed framework that uses optional forms of regulation, the Plan provides flexibility to non-price cap carriers while also creating the regulatory certainty needed in the current environment. As described in the Notice, the Plan reforms the interstate access charge structure and universal service system applicable to non-price cap LECs while implementing optional forms of incentive regulation (Path A) and rate-of-return regulation (Path B) that are consistent with the NECA pooling system. The currently authorized interstate rate of return would remain in effect for Path B, and for limited purposes for Path A. The Plan assumes that jurisdictional separations factors would be frozen consistent with the Joint Board's recent Recommended Decision in CC Docket No. 80-286.[10]

The public policy benefits of the Plan extend beyond the diverse needs of non-price cap carriers and their local customers. Under both Path A and Path B, subscriber line charges ("SLCs") will increase to be consistent with those of the *CALLS Order*. As such, the per-minute access rates that IXCs pay to non-price cap LECs will decrease. This will encourage more efficient cost recovery as well as IXC competition for the customers of Path A and Path B LECs. To protect the neediest consumers served by non-price cap LECs, for both Paths the Plan increases Lifeline support consistent with the *CALLS Order*.

The Plan seeks to provide explicit and sufficient universal service funding for the rural and high-cost areas served by non-price cap LECs. The Plan makes universal service support for

---

10 *See Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Recommended Decision, FCC 00J-2 (Jt. Bd. rel. July 21, 2000). However, the basic structure of the Plan will not change if action on that Recommended Decision is deferred.

non-price cap LECs more explicit, consistent with the Act, by defining Rate Averaging Support (the "RAS") as a residual universal service support mechanism in Path A. The Plan also promotes competition by making the RAS portable to eligible telecommunications carriers ("ETCs") in the same manner as other universal service components.

For both Path A and Path B LECs, the Plan immediately removes the "interim" cap on high cost loop support and the corporate operations expense limitation. Although the interim cap had only a minor effect on investment when first imposed, it now has a major annual impact. Indeed, one estimate of the effect of the "interim" cap is to reduce such support for rural LECs by about $118.5 million in 2000.[11] This reduction will be a significant disincentive for telecommunications investment in high cost and under-served areas.

With the caps now in place, customers lose. The current caps artificially limit the universal service support available to all carriers. Even the areas that are most in need of upgrades must make do with less in any given year that the cap operates. The caps also introduce unpredictability for incumbent LECs and CLECs alike, as an increase in support for any carrier (due, e.g., to an increase in costs) lessens the support available for other carriers. Eliminating these caps will provide LECs with greater incentives to provide improved basic services while making investments that will accommodate the delivery of advanced services in high cost areas. Removal of these caps will help all carriers to satisfy the universal service goals of Section 254 of the Act.[12]

---

11 *See* RTF Recommendation at 4, 21 n. 40, and 24 n. 46 (This figure does not include Puerto Rico).

12 *See* 47 U.S.C. § 254.

The Plan advances the Act's comparability goals for urban and rural rates and services. The Plan requires IXCs to comply fully with the geographic averaging mandate of section 254(g) of the Act, which will result in more equal treatment of IXC customers in rural areas compared to such customers in the more urban areas of the United States.[13] Because the Plan lowers per-minute access rates charged to IXCs, compliance with section 254(g) will be simplified for these carriers. The Plan thus requires IXCs to pass through to long distance customers the savings that IXCs realize from lower access charges in the areas served by LECs subject to it. The Plan proposes to formalize the elimination of IXCs' minimum monthly charges for long distance service customers in the service areas of non-price cap LECs. Similarly, the Plan benefits consumers by requiring IXCs to offer the same optional calling plans to rural and urban customers alike. The Commission has ample authority to enforce these pro-consumer regulations.

The Plan's proposed form of incentive regulation under Path A also advances the public interest by freezing Path A LECs' revenue per line ("RPL") in real terms. In doing so, the Plan ensures that Path A LECs subject to such regulation have strong incentives to improve their efficiency. As the Vander Weide testimony demonstrates, Path A LECs can increase their

[13] Under Section 254(g), the Commission must adopt rules requiring that:

> [T]he rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas. Such rules shall also require that a provider of interstate interexchange telecommunications services shall provide such services to its subscribers in each State at rates no higher than the rates charged to its subscribers in any other State.

See also 47 C.F.R. § 64.1801.

efficiency by limiting their costs.[14] They also have incentives to increase the number of lines deployed. Because Path A regulation prescribes rates for SLCs and the per-minute composite access rate ("CAR"), the Plan ensures that Path A interstate access services continue to comply with the fundamental requirements of the Act, including the duty to charge just, reasonable, and non-discriminatory rates for these services.[15] Under Path B, existing forms of regulation, combined with SLCs increased to CALLS levels, will provide this assurance.

The Plan serves the public interest by reforming current pooling mechanisms. To simplify the administration of Paths A and B, the plan replaces the present two pools administered by NECA with a single pool. NECA will retain its current ability to band rates within the pool. Path A and Path B LECs may decide on a per-study area basis whether to participate in the reformed NECA pool.

As the Group demonstrated in a filing with the Commission on December 8, 2000 (the "December 8 Filing"), the Plan is revenue-neutral for non-price cap carriers. Under the Plan, interstate access revenues, plus the new explicit universal service support mechanism known as RAS, are estimated to be about the same as access revenues are projected to be for non-price cap LECs throughout the Plan's proposed five year transition period. This estimate assumes that the current regulatory structure, authorized rate of return, and access charge levels are maintained during the Plan's five-year transition period, assuming that it begins on July 1, 2001.[16]

---

14 *See* Vander Weide testimony at pp. 2-18 through 2-19.

15 *See, e.g.*, sections 201, 202 of the Act, 47 U.S.C. §§ 201, 202. Under Path A incentive regulation, LECs will also have strong incentives to increase the number of lines served, which will advance universal service goals.

16 *See* Letter to Magalie Roman Salas, Secretary, FCC, from William F. Maher, Jr., Counsel for the Group (Dec. 8, 2000). The December 8 Filing contains numerous assumptions and qualifications regarding its estimates that are incorporated herein by reference.

The December 8 Filing also estimated possible savings under the Plan by toll end users.[17] These estimates depend on assumptions about the non-price cap carriers that elect Path A incentive regulation.

Estimated Savings To End Users					
	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006
All study areas subject to Path A incentive regulation	$84 million	$120 million	$160 million	$210 million	$265 million
All Subset 2 and Average Schedule study areas subject to Path A incentive regulation	$56 million	$80 million	$109 million	$146 million	$190 million
All Subset 2 study areas subject to Path A incentive regulation	$24 million	$42 million	$64 million	$93 million	$128 million

As an example to explain the table above, if one were to assume that all non-price cap study areas elect Path A incentive regulation, the Plan is estimated to save toll end users about $84 million dollars in the first year of the plan, starting July 1, 2001. These savings depend on IXCs passing through to their end users the savings from access charge reductions, net of universal service contributions, that they realize under the Plan. These passed-through savings are estimated to be about $301 million, which exceeds by $84 million the estimated increases in SLCs, which are expected to total about $217 million.

---

17 *See* December 8 Filing at 3. "Subset 2" study areas refer to study areas of those non-RBOC LEC holding companies with total annual operating revenues in excess of $40 million. *See* 47 C.F.R § 69.602(a).

III. THE PLAN'S ACCESS RATE CHANGES IMPROVE EFFICIENT COST RECOVERY AND ACCOMMODATE CARRIER DIVERSITY

The Plan's proposed reform of the interstate access charge system will advance the efficient provision of services to the public. The Plan's proposals to improve access charges are modeled in many important respects on the CALLS plan for price cap LECs. The SLCs of all non-price cap LECs -- that is, for both Path A and Path B -- will increase, tracking the SLC caps for carriers subject to the CALLS order (the "CALLS carriers"), so long as those caps are reasonably comparable to the CALLS carriers' actual SLCs.[18] Thus, the SLC for residential and single business lines would change to $5.00 per month on July 1, 2001, and would change consistent with the SLC caps for CALLS carriers thereafter.[19] SLCs for multi-line business lines would change from the current rate of $6.00 per line to $9.20 per line by July 1, 2003. These changes will substantially increase the portion of the common line revenue requirement recovered through flat-rated charges. NECA's tariff will reflect the SLCs described above. A non-price cap LEC electing to participate in NECA's common line tariff will not have the option of filing its own end user rates.[20]

---

18 The *CALLS Order* provides that CALLS carriers' primary residential and single-line business SLC is capped at $4.35 per line beginning July 1, 2000, $5.00 per line as of July 1, 2001, $6.00 per line as of July 1, 2002, and $6.50 per line as of July 1, 2003, subject to Commission review. *See CALLS Order*, para 70.

19 There will be no separate SLC for non-primary residence lines.

20 To clarify proposed rule section 69.3(e)(9), 66 Fed. Reg. at 7734-7735, the Group urges the Commission to insert after the third sentence of the proposed section the following:

> A carrier electing to participate in NECA's common line tariff will charge end user common line charges and carrier common line charges as prescribed in NECA's tariff. A carrier participating in NECA's common line tariff will not have the option of filing its own end user rates.

For Path A LECs, the plan also establishes a weighted per-minute aggregate target for these rates, known as the Composite Access Rate ("CAR"). Path A pool switched access rates will be adjusted to meet this target composite rate. The Plan lowers the CAR to 1.6 cents per minute on average by two years after the start of the transition period for Path A LEC study areas that participate in the pool.[21] The CAR at the 1.6 cents per minute level reflects a percentage reduction in the per-minute switched access rates of non-price cap LECs comparable to that of the *CALLS Order*. The reduction in per-minute rates under Path A in absolute terms is even more substantial than in the *CALLS Order*.[22]

These access charge changes will achieve substantial consumer benefits. The Vander Weide testimony states that the Plan addresses the Commission's concerns regarding the implicit subsidies in access charges:

> As the Commission recognized in Paragraphs 26—28 of the CALLS Order, however, the task of determining the cost of providing service in every area of the country is both difficult and time consuming, and the methods that should be used to determine the cost of providing access are highly controversial. Yet, there is common agreement that carrier access rates are currently above the traffic sensitive cost of providing access, and subscriber line charges are currently below the non-traffic sensitive cost of providing access.[23]

The balance of proposed rule 69.3(e)(9) as published in the Federal Register would follow.

21 At the start of the Plan, the CAR will be prescribed to be 2.2 cents per minute. At the end of the first year of the Plan, the CAR will be prescribed to be 1.8 cents per minute.

22 The existing composite interstate per-minute access rate for non-price cap LECs is 3.94 cents per minute, so a decrease to the 1.6 cents per minute CAR will be a reduction of 2.34 cents per minute. (The comparable current NECA pool per-minute access rate is 4.3 cents per minute, which results in a reduction of 2.7 cents per minute.)

23 Vander Weide testimony at p. 2-15.

The Vander Weide testimony notes further that SLCs in high cost rural areas cannot increase to the point of recovering all non-traffic sensitive costs without impairing the affordability of telecommunications service in high cost rural areas, and violating the Act's principle of comparability:

> In this environment, it is preferable to accept a comprehensive consensual approach that moves in the right direction, rather than to endlessly debate the complex issues involved in implementing access and universal service reform. The Plan offers such a comprehensive approach to access and universal service reform that takes reasonable steps in the right direction.
>
> The reductions in per-minute carrier access rates in the Plan are proportional to the reductions in carrier access rates already approved by the Commission. In addition, the Plan requires non-price cap LECs to increase their SLCs up to the capped levels allowed in the CALLS Plan. Thus, the Plan's reductions in carrier access rates and increases in SLCs are very similar to access changes the Commission has already approved.[24]

The adoption of similar SLCs for price cap LECs and non-price cap LECs is consistent with the rural-urban rate comparability provisions of section 254(g) of the Act.

As a more general matter, the Plan's two-path approach is necessary to accommodate the diversity that the Commission and the Rural Task Force, among others, have recognized among non-price cap carriers.[25] The Plan's similarities with the structure of the *CALLS Order*, combined with Path B's retention of existing forms of rate-of-return regulation, will help minimize the practical effects of any purported regulatory complexity.[26] If adopted as presented

---

[24] *Id.* at pp. 2-15 through 2-16 (footnote omitted).

[25] *See supra* note 6, *The Rural Difference* at 31 (stating that "[c]osts of facilities, operating costs, and customer composition vary significantly among Rural Carriers, emphasizing the importance of not over-generalizing from average-profile information."); *see also Access Charge Reform Notice*, 13 FCC Rcd at 14244 (recognizing that non-price cap carriers "are not . . . a homogenous group, and their operating conditions vary significantly").

[26] The NECA pooling system as modified in the Plan will simplify the regulatory tasks of the Commission's staff by continuing to limit the number of tariffs filed by non-price cap LECs. The Group has worked closely with NECA to ensure that the plan is administratively feasible.

in the Petition, the Plan will benefit all non-price cap carriers because of the flexibility that they will have in selecting either Path A or Path B, which permits LECs choosing that option to transition to Path A.

In the December 8 Filing, the Group estimated the potential access charge reductions under the Plan.[27] These estimates vary depending on assumptions about the participants in Path A of the Plan.

Estimated Access Charge Savings To IXCs					
	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006
All study areas subject to Path A incentive regulation	$702 million	$914 million	$1.1 billion	$1.2 billion	$1.3 billion
All Subset 2 and Average Schedule study areas subject to Path A incentive regulation	$471 million	$665 million	$817 million	$883 million	$956 million
All Subset 2 study areas subject to Path A incentive regulation	$333 million	$521 million	$667 million	$719 million	$778 million

As an example to explain the foregoing table, if one were to assume that all non-price cap study areas elect Path A incentive regulation, in 2001-2002, IXCs are estimated to save about $702 million in access charges under the Plan. This is calculated as the decrease in access rates times projected minutes of use.

Over the period 2001 through 2006, the total estimated access charge savings based on the table above are significant:

Attachment 1 describes NECA's view of a feasible schedule for implementing the Plan, beginning with changes related to the proposed SLC increase on July 1, 2001, and other changes beginning on January 1, 2002. The Group endorses NECA's views expressed in Attachment 1.

27 *See* December 8 Filing at 3.

Estimated Total Access Charge Savings To IXCs: 2001-2006	
All study areas subject to Path A incentive regulation	$ 5.21 billion
All Subset 2 and Average Schedule study areas subject to Path A incentive regulation	$ 3.79 billion
All Subset 2 study areas subject to Path A incentive regulation	$ 3.01 billion

Path A LECs and Path B LECs would be subject to the same SLC increases. As described above, the per-minute access rates of Path A LECs would be decreased to meet the CAR level of 1.6 cents per minute. Per-minute access rates of Path B LECs also would be lower than they would have been without the SLC increases proposed in the Plan. As noted in the Petition, the Group expects LECs that serve a majority of non-price cap access lines to elect Path A, assuming that Paths A and B remain as defined in the Plan. However, the Group believes that it is inadvisable to attempt to distinguish between "larger carriers" and "small carriers" in attempting to predict which carriers will select either Path A or Path B.[28] Each non-price cap LEC will have to perform its own analysis of the relative costs and benefits of these paths. Because Path A incentive regulation is based on freezing a carrier's RPL, it is reasonable to expect that non-price cap LECs that face stagnant line growth or decreases in the number of lines that they serve will be less likely to select Path A. The Vander Weide testimony explains that:

> Incentive regulation is inappropriate for those rural carriers serving areas with limited growth, or even negative growth, due to out-migration of population. In situations of low or negative growth, carriers have limited opportunities to reduce costs and increase revenues. Nonetheless, these carriers are obligated to serve as carriers of last resort: they must maintain the network and the capability to serve all consumers in face of negative growth. Given the unfavorable demographics of these rural companies' service territories, these companies will have limited incentive to introduce new technologies and services unless they receive some assurance that they will have the opportunity to recover

28 *See* Notice, 66 Fed. Reg. at 7726, para. 5.

> the costs of their investments in rates. Rate of return regulation provides this necessary assurance.[29]

As part of the Plan, the Commission should terminate its pending rate-of-return represcription proceeding[30] without decreasing the authorized rate of return from its current level of 11.25 percent.[31] The authorized rate of return most directly affects Path B LECs, which will continue to be subject to rate-of-return regulation, as well as Path A LECs prior to becoming subject to Path A incentive regulation. However, it also is used for the low end adjustment in Path A,[32] as well as for the low end adjustment for price cap LECs. As the Vander Weide testimony demonstrates, investments in telecommunications facilities are long-term and cannot be reversed. As a result, non-price cap LECs will be more likely to invest in new facilities if they have reasonable assurances that they will be able to earn an adequate return on their investments over the life of the facilities.[33] According to the Vander Weide testimony:

> By continuing the current 11.25 percent authorized rate of return, the Commission can reduce the uncertainty about the prospective returns the non-price cap LECs are likely to achieve on investments in new telecommunications technologies and services. Thus, the non-price cap LECs will be more likely to invest in new telecommunications technologies and services if the Commission affirms the current authorized rate of return.[34]

---

29 Vander Weide testimony at p. 2-6.

30 *See* Represcription Notice, *supra* note 8.

31 In the represcription proceeding, the associations in the Group urged the Commission to increase the prescribed rate of return if it chose to act in that proceeding. The associations demonstrated that the current authorized interstate rate of return of 11.25% is a conservative estimate of all LECs' current and prospective capital costs. *See* Joint Direct Case and Comments of Local Exchange Carrier Associations, CC Docket No. 98-166 (filed Jan. 19, 1999).

32 *See* Vander Weide testimony at pp. 2-20, 2-21.

33 *See id.* at p. 2-21.

34 *See id.*

In this regard, Dr. Vander Weide provided evidence in CC Docket 98-166, the pending represcription proceeding, that the non-price cap LECs' cost of capital exceeds the Commission's currently authorized 11.25 percent rate of return. The Group believes that retention of the present authorized interstate rate of return is essential to the success of the Plan under both Path A and Path B.

IV. THE PLAN PRESENTS THE BEST MEANS OF REFORMING THE UNIVERSAL SERVICE SUPPORT SYSTEM FOR NON-PRICE CAP LECs

The Plan is a substantial advance in implementing the universal service principles of the Act for customers in the service areas of non-price cap LECs. As the Notice observes, the Plan does not seek to estimate the amount of implicit support currently in non-price cap LEC access rates. However, as discussed above, the Plan's reform of the access charge system for both Path A and Path B LECs, consistent with the *CALLS Order*, goes far to removing implicit subsidies from that system.

As the Commission recognized in the *CALLS Order*, the Commission has broad discretion in conducting universal service reform to balance the goals of providing explicit and sufficient universal service support and promoting local competition.[35] Implementation of the RAS as described in the Plan is a sound exercise of this discretion. The Plan defines the RAS as a new explicit support mechanism available only to the study areas of Path A LECs that participate in the NECA pooling system. The immediate availability of the RAS in Path A should

---

[35] *See CALLS Order* para. 192, *citing Alenco v. FCC*, 201 F.3d 608, 620 (5th Cir. 2000), *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 412 (5th Cir. 1999).

motivate non-price cap LECs to move to Path A and incentive regulation. Path A incentive regulation in turn will send the proper economic signals to promote efficient investment.

By sending the correct economic signals, Path A incentive regulation provides increased opportunities for efficient competitive entry. The lower prescribed per-minute rate for Path A will be an incentive for companies to move to Path A at any time during the five-year transition period. The Plan's one-way optionality will encourage the shift to Path A and promote competition among a greater number of carriers. The Commission therefore has ample policy reasons and legal discretion for associating the RAS with Path A rather than Path B.

Because, under Path A, the Plan prescribes both SLCs and per-minute access rates so as to lower the implicit subsidies that they formerly contained, the RAS is a reasonable mechanism for making such implicit subsidies explicit. For those non-price cap LECs that elect Path B regulation, retaining the existing universal service support structure will be permissible under the Act, as it is now.[36]

The *CALLS Order* established a universal service mechanism, which it called "interstate access support" for price cap carriers that is capped at $650 million per year. This capped amount was the product of a negotiation among a limited set of IXCs and price cap LECs. Unlike this limited set of CALLS participants, the more than 1000 non-price cap LECs that would be subject to the Plan have widely varying universal service needs. A capped mechanism would not provide the assurance that funding would be sufficient pursuant to section 254 of the Act. Rather than relying on a capped "interstate access support" mechanism, a more flexible

---

[36] Path B LECs will be situated differently from Path A LECs in additional respects because, since, among other things, the Plan does not prescribe per-minute access rates for Path B LECs as it prescribes the CAR for Path A LECs.

residual mechanism such as the RAS is best able to meet the statutory goals of being "explicit and sufficient" to achieve the purposes of section 254 of the Act.[37]

Moreover, even as a residual mechanism, for the first years of the Plan the RAS is estimated to be smaller than the "interstate access support" mechanism of the *CALLS Order*, depending on assumptions about participation in both Path A and the pool.[38] The December 8 Filing presented estimates of the size of the RAS at the beginning and the end of the Plan's five-year transition period, based on a variety of assumptions about participation in Path A and the pool.

Estimated Size Of RAS						
	July 1, 2001	July 1, 2002	July 1, 2003	July 1, 2004	July 1, 2005	July 1, 2006
All study areas subject to Path A incentive regulation	$521 mill.	$530 mill.	$541 mill.	$575 mill.	$613 mill.	$654 mill.
All Subset 2 and Average Schedule study areas subject to Path A incentive regulation	$257 mill.	$258 mill.	$259 mill.	$270 mill.	$281 mill.	$291 mill.
All Subset 2 study areas subject to Path A incentive regulation	$119 mill.	$120 mill.	$121 mill.	$125 mill.	$129 mill.	$132 mill.

Because the RAS is a residual support mechanism, the gradual increases shown in the foregoing estimates are likely to be offset by decreases in access rates and charges resulting from Plan implementation. As noted in section II above, the Plan's estimated savings to end users in non-price cap LEC areas are significant.

Even with the presence of the RAS as a residual support mechanism in Path A, the Commission should retain long term support ("LTS") and local switching support ("LSS") as distinct universal service mechanisms. LTS helps reduce the portion of the carrier common line

37 *See* 47 U.S.C. §254(e).

38 *See* December 8 Filing at 3-4.

revenue requirement that is collected through per-minute rates, while LSS helps reduce per-minute local switching rates. Accordingly, if either LTS or LSS were not available, the RAS would increase.

As explained in the Plan, a portion of the RAS will be available to certain Path A pooling LECs in high-cost areas whose special access revenue requirements are not being covered by the average NECA tariff rates at the time of Plan implementation.[39] This portion of the RAS is designed to prevent rate shock for the special access customers in these high-cost service areas, whose rates would increase as a result of low-cost LECs having the option under the Plan to file their own special access tariffs. This portion of the RAS is essential to ensure that LECs in these high-cost areas continue to invest in and deploy the latest technology needed to deliver to rural areas advanced services as well as services supported under the universal service program.[40]

Since many special access services are highly competitive, even in the service areas of non-price cap LECs, this portion of the RAS will ensure that competition is not stifled by the inability of affected companies to compete in high-cost areas.[41] This portion of the RAS will also help keep switched transport rates in these areas reasonably comparable to those in more urban areas, consistent with section 254(g) of the Act, since the transport rates for switched

---

[39] *See, e.g.,* Plan Description at n. 16.

[40] In this regard, we note that in the Commission's model to estimate universal service support for non-rural LECs, the model provides support for copper loops of up to 18,000 feet, thereby supporting costs of accessing advanced services not covered in the definition of universal service. *See Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, 13 FCC Rcd 21323 (1998) paras. 68-70.

[41] In seeking to accommodate these universal service and competitive policy interests, the Commission has discretion to adopt this mechanism. *See supra* note 35 and accompanying text.

services are largely based on special access rates. This "special access" portion of the RAS is portable to competing ETCs offering special access services in these high-cost areas.[42]

It is unnecessary for the Commission to adopt a provision similar to that included in the *CALLS Order* for recovery of universal service contributions through a separate rate element or line item.[43] Non-price cap LECs' existing access rate elements and line items are sufficient and explicit means of recovering such contributions. To require non-price cap LECs to implement such mechanisms would be costly and administratively burdensome. At most, the Commission should grant flexibility to non-price cap LECs to permit them to implement such mechanisms. This flexibility would be consistent with the requirements of the Act and the Commission's general practices.[44]

V. PATH A INCENTIVE-BASED REGULATION PROVIDES STRONG INCENTIVES FOR EFFICIENT INVESTMENT AND OPERATIONS

As the Vander Weide testimony demonstrates, Path A incentive regulation under the Plan creates strong economic incentives for operating efficiency and investment:

> [T]he Plan requires the non-price cap LECs who choose Path A to move to incentive regulation by the end of a five-year transition period. Prior to the end of the five-year transition period, Path A companies can move to incentive regulation on an individual study area basis....[I]ncentive regulation provides enhanced incentives for cost reduction and investment in new technologies by breaking the link between a company's costs and

---

42 This portion of the RAS would be available to the ETC based on the Path A LEC's percentage of special access RAS to total special access revenues. A competing ETC that serves special access customers in these areas would receive the same percentage of its billed revenues in the form of RAS.

43 *See CALLS Order* para. 218.

44 *See, e.g., Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 425 (5th Cir. 1999); *Federal-State Joint Board on Universal Service; Access Charge Reform*, 15 FCC Rcd 1679, 1693 (1999).

its revenues. If a company is able to reduce its costs through increased efficiency or investment in new technologies, its profits will increase.[45]

The Plan's form of incentive regulation thus is likely to encourage long term investment in new technologies, including investment in high-speed infrastructure.[46]

The Plan's five-year transition period, during which Path B LECs may elect Path A, and Path A LECs may move to incentive regulation on a per-study area basis, accommodates the "lumpy" investment patterns (significant investment in a single year, rather than a steady flow of investment) of non-price cap LECs. Path A incentive regulation will not create or reinforce such lumpy investment. This investment pattern already occurs for non-price cap LECs because of their small size, limited investment resources, and the constraints imposed by state regulation of their intrastate services. For many smaller LECs, lumpy investment is a fact of life because of the limited extent of their facilities, which cannot constantly be replaced. The length of the Plan's proposed transition period balances the need to accommodate such investment patterns with the goal of widespread implementation of incentive regulation. The transition period is an essential component of the move to incentive-based regulation.

Similarly, by permitting LECs to elect on a study area basis when to convert to incentive-based regulation and whether to continue pooling, the Plan provides flexibility for LECs to match the pace of regulatory reform with the particular circumstances of their individual study

---

45 Vander Weide testimony at p. 2-18. Any artificial limit on returns under this form of incentive regulation would discourage these pro-efficiency incentives.

46 *See Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, Second Report, FCC 00-290 (released Aug. 21, 2000), at para. 267 (*Second Report*) (stating the Commission's commitment to "consider developing an incentive-based approach for [non-price cap carriers] to use current revenues for investment in high-speed infrastructure.").

areas. Because many non-price cap LECs participate in the NECA pooling system, NECA will be responsible for administering the choice that pool participants make under the Plan. At the end of the transition period, of course, incentive regulation will take effect in all Path A study areas.

Consumers will benefit from the efficiency gains that incentive-based regulation is expected to produce by being able to use the new technologies that LECs will have incentives to install. By breaking the link between revenues and costs, the RPL-based regulation of Path A enhances incentives for reducing costs and investing in new technologies. As the Vander Weide testimony shows:

> Incentive regulation encourages allocative efficiency by giving companies the flexibility to more closely align rates with the manner in which costs are incurred. Thus, incentive regulation generally produces rates that provide stronger economic signals to customers about the level of society's resources they are consuming. Economic theory suggests that stronger price signals lead to a more efficient allocation of society's resources.[47]

As discussed in section II above, the Plan is revenue-neutral for non-price cap LECs overall. Because Path A LECs under incentive regulation will have frozen per-line revenues, in real terms, they will be able to increase revenues by increasing line growth. Otherwise, they will be able to increase margins by increasing their efficiency and decreasing their costs per line.

Within the structure of Path A incentive regulation, the use of the Gross Domestic Product-Chained Price Index ("GDP-PI") as an inflation adjustment factor is a reasonable means of ensuring that RPL is frozen in real terms. This inflation index is the same one used in the *CALLS Order* and the RTF recommendation. The Vander Weide testimony explains that:

> An inflation adjustment is a common feature of incentive regulation plans in the telecommunications industry. For example, the FCC has included an inflation adjustment in its price cap plan for the price cap LECs, and the Rural Task Force has included an

---

[47] Vander Weide testimony at p. 2-5.

inflation adjustment in its final recommendations for universal service support (see Section IV, B, 1, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service, adopted September 22, 2000). The Rural Task Force recognized that universal service funding must be adjusted for both line growth and inflation if rural carriers are to have an incentive to make the infrastructure investments required to provide access to advanced services:

> The federal universal service support fund should be sized so that it presents no barriers to investment in plant needed to provide access to advanced services. Specifically, to remain "sufficient" under the 1996 Act, the fund should be sized so that investment in rural infrastructure will be permitted to grow. [Section IV, A, 1, c.][48]

Path A incentive regulation does not and should not include an X-factor or other productivity adjustment of the RPL. The Group believes that it is infeasible to develop an adjustment factor that reflects the productivity of non-price cap LECs compared to the rest of the economy. Taken together, the non-price cap LECs are a small part of the incumbent LEC industry, serving only about seven percent of U.S. access lines. The Commission had extreme difficulty in developing a productivity factor for the price cap LECs, and in the CALLS Order stopped defending such a factor as a measure of productivity.[49] The diversity, number, and relatively small size of the non-price cap LECs pose even more difficult problems in determining a productivity factor that rationally reflects the productivity characteristics of these LECs, either individually or as a group.

In the Commission's original form of price cap regulation, the productivity factor operated to reduce the caps for the prices of interstate services. The "X-factor" adopted in the

---

48 Vander Weide testimony at p. 2-19.

49 *See, e.g., CALLS Order* at paras. 138-139; *see also United States Telephone Association v. FCC*, 188 F.3d 521, 525-530 (D.C. Cir. 1999).

CALLS Order for price cap LECs has the same purpose.[50] Neither type of factor directly limits the revenues per line of any carrier.

In contrast, if the Commission were to apply a productivity factor or X-factor to the RPL, over time the factor could so reduce RPL that only those carriers with the least costs or the strongest line growth would even consider whether to elect Path A incentive regulation. This unintended consequence of imposing a productivity factor on the Plan's type of incentive regulation would limit – and could negate – the pro-efficiency incentives of Path A incentive regulation.

The Plan's proposed low end adjustment feature for Path A incentive regulation is necessary to ensure investment in new telecommunications technologies. The Vander Weide testimony notes:

> Most non-price cap carriers operate in high cost low-density rural areas that are both costly and difficult to serve. Non-price cap LECs are unlikely to make investments in new telecommunications services and technologies in these areas without some backstop rate of return on their investment. By supplying this backstop, the LEA [low end adjustment] feature provides an incentive for the Path A non-price cap LECs to take the risk of investing in their high cost service territories. In this regard, the LEA feature of the Plan is similar to the protections already enjoyed by the price cap LECs.[51]

The low end adjustment therefore is an integral part of Path A regulation, as it has been for price cap regulation. As competitive entry increases in the service areas of Path A LECs, the low end adjustment will become increasingly important. Although competition will center on the few low-cost, high-volume business customers in their service areas, Path A LECs will continue to have carrier-of-last-resort obligations for high-cost residential customers. The low end

[50] *See CALLS Order* para. 160 (describing X-factor as a "transitional mechanism to lower access charges to target rates for switched access, and to lower rates for a specified time for special access").

[51] *See* Vander Weide testimony at p. 2-20.

adjustment will be an important backstop to ensure that returns will be adequate for Path A LECs to continue to invest in and improve their networks. The availability of such an adjustment in Path A undoubtedly will be an important factor when non-price cap LECs evaluate the relative risks of Path A and Path B.

The low end adjustment defined in the Plan best meets the needs of non-price cap LECs. As described in the Petition, each adjustment is for a one-year period only -- the adjusted rates do not continue indefinitely. LECs with five or fewer study areas that realize study area returns more than 50 basis points less than 11.25% would be entitled to a one-time earnings adjustment to bring their study area return for the relevant year to 10.75%. Path A LECs with more than five study areas subject to incentive regulation that under-earn by more than 100 basis points less than 11.25% in a study area would be eligible for a one-time earnings adjustment to bring their study area return for the relevant year to 10.25%.[52] By distinguishing among LECs based on the number of their study areas, the adjustment recognizes that non-price cap LECs with relatively few study areas may be more geographically localized and subject to greater risks than those with more dispersed study areas.

The Plan's proposed rules for the low end adjustment require LECs to report cost data that will permit the Commission to evaluate the validity of low end adjustment showings.[53] Because, in general, each adjustment applies only for a year, periodic cost reporting is unnecessary for this purpose.

---

[52] Rules for applying for a low end adjustment differ for study areas in or out of the pool. *See* Plan Description at pp. 1-11 through 1-12; 1-15 through 1-16.

[53] *See* proposed rule §61.62(c), 66 Fed. Reg. at 7733-7734.